

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

*Question Nos 1, 2 and 3 are compulsory.
Answer any four questions from the rest of the questions.*

Question 1

Answer any two of the following:

- (a) *A is Managing Director of APAR Ltd. He gave his resignation letter to the Chairman of the Board of Directors on 31st December, 2005 and requested that he should be relieved immediately. When does the resignation of Mr. A take effect? (5 Marks)*
- (b) *On 31st March, 2006 D holds certain securities issued under 'Collective Investment Scheme.' His name appears in the books of the scheme. He has transferred these securities to another person for a consideration. The transferee lodged the instrument of transfer with the authorities one month after the date on which the income on these securities became due. Examining the provisions of the Securities Contracts (Regulation) Act, 1956 state:*
 - (i) *Whether D is entitled to receive and retain the income on these securities for the financial year ended 31st March, 2006 in the given case?*
 - (ii) *Would your answer be still the same in case the transferee lodged the instrument of transfer with the authorities 14 days after the date on which the income on these securities became due? (5 Marks)*
- (c) *The Executive Committee of a recognized Stock Exchange desires to transfer certain duties and functions of a clearing house to a recently set up Clearing Corporation, incorporated as a company under the Companies Act, 1956. Examining the provisions of the Securities Contracts (Regulation) Act, 1956:*
 - (i) *State the purpose for which such transfer of duties and functions can be made to Clearing Corporation.*
 - (ii) *What is the procedure to be adopted for such transfer of duties and functions? (5 Marks)*

Answer

- (a) A director can resign from his office by serving a notice of his resignation upon the Company or the Board. There is no need for its acceptance by the Board or the Company.

However, if a Managing Director resigns, he cannot give up his office at his pleasure simply by serving the notice. This is because he occupies two positions i.e., of a director and an employee. In case of Managing Director, the notice or letter of resignation is required to be approved or accepted by the company and he has to be relieved of his duties and responsibilities attaching to his office from which he has resigned. Similar views were accepted in the case of *Achutha Pal vs. Registrar of Companies (1956) 36 Comp. Cases 598*.

Accordingly, in the given case, the resignation of A, the Managing Director shall be

effective when approved or accepted by the company and he is relieved of his duties and responsibilities attaching to his office from which he has resigned.

- (b) Transfer of securities under Collective Investment Scheme under the Securities Contracts (Regulation) Act, 1956 (Section 27A)

Problem as asked in the question is based on the provisions of Section 27A of the Securities Contracts (Regulation) Act, 1956, wherein it shall be lawful for the holder of any securities, being units or the other instruments issued by collective investment scheme, whose name appears on the books of the scheme, issuing the said security to receive and retain any income in respect of units issued by the scheme in respect thereof for any year, notwithstanding that the said security, being units issued by the scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units issued by the scheme from the transferor has lodged the security and all other documents relating to the transfer which may be required by the scheme with the scheme for being registered in his name within 15 days of the date on which the income in respect of units or other instruments issued under the scheme became due. The period of 15 days can be extended in certain contingencies as stated in Explanation to Section 27A (1).

Applying the above provisions in the given case:

- (i) the holder of securities (i.e. D, the transferor) has right to receive or retain the income on these securities for the financial year ended 31st March, 2006, since the instrument for transfer was lodged one month after the date on which the income became due.
 - (ii) The answer in the second case would differ. The holder (i.e. D, the transferor) cannot receive and retain the income since the instruments for transfer was lodged with the company within the statutory period of 15 days by the transferee.
- (c) Transfer of certain duties and functions of a clearing house by a stock exchange to clearing corporation under the Securities Contracts (Regulation) Act, 1956 (Section 8A)

Purposes:

A recognized stock exchange may, with the prior approval of the Securities and Exchange Board of India, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956 for the purpose of:

- (i) the periodical settlement of contracts and differences thereunder,
- (ii) the delivery of, and payments for, securities;
- (iii) any other matter incidental to, or connected with, such transfer.

Procedure:

1. Every clearing corporation shall for the purpose of transfer of the duties and functions of a clearing house to clearing corporation make bye-laws and submit the

same to the SEBI for approval.

2. The SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of a clearing house to a clearing corporation, grant approval to the bye-laws submitted to it under sub-section (2) and approve transfer of the duties and functions of a clearing house to a clearing corporation.
3. The provisions of Sections 4 to 12 shall, as far as may be, apply to a clearing corporation as they apply in relation to a recognized stock exchange.

Question 2

Answer any two of the following:

- (a) *State which kind of approval is required for the following transactions under the Foreign Exchange Management Act, 1999:*
 - (i) *X, a Film Star, wants to perform alongwith associates in New York on the occasion of Diwali for Indians residing at New York. Foreign Exchange drawal to the extent of US dollars 20,000 is required for this purpose.*
 - (ii) *F International Ltd. has purchased the trade mark from a Foreign Company to establish retail business chain in India as a joint venture at a consolidated price of US dollars 500,000 which is to be paid in Foreign currency of that country.*
 - (iii) *R wants to get his heart surgery done at UK. Up to what limit Foreign Exchange can be drawn by him and what are the approvals required ?*
 - (iv) *L wants to pursue a course in Fashion design in Paris. The Foreign Exchange drawal is US dollars 20,000 towards tuition fees and US dollars 30,000 for incidental and stay expenses for studying abroad. (7 Marks)*
- (b) *A French Manufacturing Company desirous of setting up its branch office at Pune, seeks your advice on the objects for which the company may be allowed to set up the desired branch office. Advise the company about the procedure as required under the Foreign Exchange Management Act, 1999 to be followed in this regard. (7 Marks)*
- (c) *Examine with reference to the relevant provisions of the Competition Act, 2002 the following:*
 - (i) *Whether a Government Department supplying water for irrigation to the Agriculturists after levying charges for water supplied (and not a water tax) can be considered as an 'Enterprise'.*
 - (ii) *Whether a person purchasing goods not for personal use, but for resale can be considered as a 'consumer.' (7 Marks)*

Answer

- (a) Approval to the following transactions under FEMA, 1999 :
 - (i) Foreign Exchange drawals for cultural tours require prior permission/approval of the

Government of India irrespective of the amount of foreign exchange required. Therefore, in the given case X, the Film Star is required to seek permission of the Government of India.

- (ii) In this case prior permission/approval of RBI is required for purchasing trade mark from a foreign company where purchase consideration is to be paid in foreign currency. Therefore, F International Ltd. needs prior permission of RBI.
 - (iii) Remittance in foreign exchange for medical treatment abroad requires prior permission/approval of RBI when the expenditure in foreign currency exceeds the estimate of hospital/doctor abroad or estimate from doctor in India in that field of treatment. Therefore, R can draw foreign exchange up to the estimate of hospital/doctor abroad or estimate from doctor in India in that field of treatment and prior permission/approval of RBI is required.
 - (iv) Release of foreign exchange for education abroad is permitted up to US\$ 1,00,000 on self declaration basis. Therefore, L can draw foreign exchange on self declaration basis for pursuing a course in fashion design in Paris.
- (b) Setting up a branch office at Pune by a French company – Objects and the procedure under the FEMA, 1999 :

Since setting up a branch office by a foreign company in India involves foreign exchange, permission of RBI is required. Following are the objects for which RBI permits companies engaged in manufacturing and trading activities abroad to set up Branch Office in India:

1. To represent the parent company/other foreign companies in various matters in India e.g. acting as buying/selling agents in India.
2. To conduct research work in the area in which the parent company is engaged.
3. To undertake export and import trading activities.
4. To promote possible technical and financial collaborations between the Indian companies and overseas companies.
5. Rendering professional or consultancy services.
6. Rendering services in information technology and development of software in India.
7. Rendering technical support to the products supplied by the partner/group companies.

Steps / procedure:

1. Foreign company can set up Branch Offices in India after obtaining approval from RBI.
2. The office can act as a channel of communication between Head Office abroad and parties in India. It is not allowed to undertake any business activity in India and cannot earn any income in India. Expenses of such offices are to be met entirely through inward remittances of foreign exchange from the Head Office abroad.

3. Permission to set up such office is initially granted for a period of 3 years and this may be extended from time to time by the Regional Office in whose jurisdiction the office is set up.
4. The representative office will have to file an annual activity certificate etc. from a Chartered Accountant to the concerned Regional Office of the RBI.
5. Application is required to be made in Form FNC-1.

(c) Competition Act, 2002:

Enterprise: The term 'enterprise' is defined in Section 2(h) of Competition Act, 2002. Accordingly 'enterprise' means a person or a department of the Government, who or which is engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services of any kind. But the term does not include any activity of the Government relatable to sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Certain specific activities of Government departments like dealing with atomic energy, etc., and sovereign functions of the Government (like police, defence, etc.) are excluded from the purview of the said terms. Hence, a Government department engaged in the activity of providing service in the form of supply of water for irrigation to the agriculturists after levying charges can be considered as an 'enterprise' within the meaning of Section 2(h) of Competition Act, 2002.

Consumer: The term 'consumer' is defined in Section 2(f) of Competition Act, 2002. Accordingly 'consumer' means any person who buys any goods for a consideration, which has been paid or promised or partly paid and partly promised, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence, it is not necessary that a person must purchase the goods for personal use in order to be considered as a 'consumer' under Competition Act, 2002. Even a person purchasing goods for resale or for any commercial purpose will also be considered as a 'Consumer' within the meaning of Section 2(f) of Competition Act, 2002.

Question 3

Answer any two of the following:

- (a) *SEBI received complaints from some investors alleging that ABC Ltd. And some brokers are indulging in price manipulation in the shares of ABC Ltd. Explain the powers that can be exercised by SEBI under the Securities and Exchange Board of India Act, 1992 in case the allegations are found to be correct. (8 Marks)*
- (b) *A designated Financial Institution under the Companies Act, 1956 proposes to go for issue of shares. Referring to the SEBI guidelines the institution seeks your advice on the following:*
 - (i) *What minimum reservation to promoters is to be made by the Financial Institution ?*
 - (ii) *To what conditions shall the Financial Institution be subject to, for reservation for*

employees out of the proposed issue? Advise.

(8 Marks)

- (c) *What are the Internal and External aids to interpretation of statutes ? Give five examples each of Internal and External aids.* *(8 Marks)*

Answer

- (a) SEBI Act, 1992: Price manipulation in the shares of ABC Ltd. can be considered as fraudulent and unfair trade practices relating to securities market. In this case SEBI may exercise the following powers under Section 11(4) of securities and Exchange Board of India Act, 1992.

- (i) Suspend the trading of any security (in this case the securities of ABC Ltd.) in a recognized stock exchange.
- (ii) Restrain persons (in this case ABC Ltd.) from accessing the securities market. It can also prohibit any person associated with securities market (i.e. brokers who have indulged in price manipulation) to buy, sale or deal in securities market.

SEBI may issue the above orders for reasons to be recorded in writing. SEBI shall, either before or after passing such orders give an opportunity of hearing to company and brokers concerned (proviso 2 to Section 11(4))

SEBI may also appoint an adjudicating officer who may levy penalty under Section 15 HA after holding an enquiry in the prescribed manner. According to Section 15HA if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of Rs. 25 crores or 3 times the amount of profits made out of such practices, whichever is higher.

Prohibition on manipulation and deceptive practices: Further according to Section 12A, no person shall directly or indirectly indulge in following (i.e.) (a) using in manipulative or deceptive device in connection with purchase, sale or securities listed (b) Employ any scheme or device to defraud in connection with dealing in securities which are listed (c) engage in an act which would operate as fraud on deceit upon any person in connection with dealing in securities which are listed. SEBI may impose penalty upto Rs. 1 crore on any person who fails to comply with any provisions of SEBI Act (Section 15 HB).

- (b) Issue of shares by designated financial institution: SEBI Guidelines

The designated financial institutions viz. Public Financial Institution as defined under Section 4A of the Companies Act, 1956 approaching the capital market for funds through an offer document, shall be subject to the following guidelines:

- (i) Promoters' Contribution: There is no requirement of minimum promoters' contribution in respect of any issue made by DFIs. In case any DFI proposes to make a reservation for promoters, such contributions from the promoters shall come only from actual promoters and not from directors, friends, relatives, associates, etc.

- (ii) Reservation for Employees:

- 1. The DFIs may make a reservation out of the proposed issue for allotment only

to their permanent employees including their Managing Director(s) or any whole time Director.

2. Such reservation shall be restricted to the number of permanent employees on the pay rolls of the DFIs as on the date of the offer document multiplied by 200 shares of Rs. 10 each or 20 shares of Rs. 100 each as the case may be per employee, subject to a maximum of 5% of the issue size.
3. The shares allotted under the reserved category shall be subject to a lock in period of 3 years.
4. In case of public issue, unsubscribed portion, if any, in the reserved category shall be added back to the public offer.
5. In case of right issue, unsubscribed portion if any, shall lapse.
6. Where the Managing Director or the Whole Time Director represents the promoters, he may acquire securities as part of the promoters' contribution but not under the reservation made for the employees in the proposed issue.

Thus the answer to the given question shall be as under:

1. There is no requirement of minimum reservation for promoters in the public issue by the designated financial institution.
2. Reservation to employees can be made subject to the conditions as stated above.

- (c) Internal aids to interpretation / construction are those which are found within the text of the statutes. On the other hand external aids of interpretation are those factors which are external to the text of the statute but are of great help.

Examples of internal aids to interpretation:

1. Definitional sections and clauses
2. Illustrations
3. Provisos
4. Long title and short title
5. Preambles
6. Heading and title of chapter
7. Marginal notes
8. Explanations
9. Schedules
10. Reading the statute as a whole

Examples of external aids to interpretation:

1. Historical setting (Background)

2. Consolidating statute & Previous law
3. Usage
4. Earlier & later analogous acts
5. Earlier acts explained by the later act
6. Reference to repealed acts
7. Dictionary definition
8. Use of foreign decisions

Question 4

- (a) *Clever, a Director of ABC Ltd. Made default in filing of Annual Accounts and Annual Returns with the Registrar of Companies for a continuous period of three financial years ending 31st March, 2005. Referring to the provisions of the Companies Act, 1956 examine the validity of the following:*
- (i) *Whether X can continue to be a Director of ABC Ltd. And also EF Ltd., where he is a Director. Also state whether he can be reappointed as a Director in ABC Ltd. as well as EF Ltd.*
 - (ii) *Would your answer be still the same in case X is a nominee Director of a Public Financial Institution ?*
 - (iii) *What would be your answer in case the defaulting company (i.e. ABC Ltd.) is a Private Company ?* (8 Marks)
- (b) *A meeting of members of a Company was convened under the orders of the court to consider a scheme of compromise and arrangement. The meeting was attended by 200 members holding 5,00,000 shares in aggregate. 70 members holding 4,00,000 shares voted for the scheme. The remaining members voted against the scheme. Examine with reference to the relevant provisions of the Companies Act, 1956 whether the scheme is approved by the required majority.* (7 Marks)

Answer

- (a) In accordance with the provisions of Section 274(1)(g) a person shall not be capable of being appointed as director of a company if such person is already a director of a public company, which –
- (A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999;
- Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of 5 years from the date on which such public company, in which he is a director failed to file annual accounts and annual returns under this clause.
- Applying the above provisions as contained in Section 274(1)(g), answers to the given questions are:

1. In the given case, Mr. Clever, the Director of ABC Ltd. is disqualified to be appointed as Director of other public companies for a period of 5 years from the date on which default has been committed.
2. In the second case, Mr. Clever, as a nominee of the Public Financial Institution, shall not be disqualified to be appointed as Director for the reason that the Public Financial Institutions and are exempted from the provisions of Section 274(1)(g) of the Companies Act, 1956.
3. A director of a private company is not disqualified even if that company is a defaulter in filing return.

Mr. Clever does not cease to be a director in ABC Ltd. and EF Ltd. immediately because Section 283 which provides for 'vacation of office' has not been amended. He can continue as a director till his term ends. But he can be reappointed in the defaulting company ABC Ltd., but not in EF Ltd. as the disqualification applies only to 'any other public company'.

(b) Scheme of compromise and arrangement / amalgamation

The majority required to consider a scheme of compromise or arrangement under Section 391(2) of the Companies Act, 1956 is a majority in number representing 3/4th in value of the members present and voting either in person or, where proxies are allowed by proxy at the meeting, agree to the scheme of compromise or arrangement. The majority required two separate compliances to constitute the passage of the resolution approving the scheme placed before the meeting -

(1) majority in number must vote for the scheme (2) they must compulsorily held three-fourths of the total value of the shares of all the members present and voting at the meeting.

Here the scheme is approved by members holding more than three fourths in value of the total value of shares. But as only 70 members voted for the scheme as against 130 members voting against the scheme, the second requirement of majority in number approving the scheme is not complied with. Hence the scheme is not approved by the required majority under Section 391(2) of the Companies Act, 1956.

Question 5

- (a) *From the following information extracted from the Balance Sheet of VCD Ltd. as at 31st March, 2006, Board of Directors of the Company decide to grant a loan of Rs. 80 crores to another company JN Ltd.*

	Rs. (in crores)
<i>Paid-up Share Capital:</i>	
<i>Equity Share Capital</i>	50
<i>Preference Share Capital</i>	10
<i>General Reserves</i>	100
<i>Debentures</i>	5
<i>Debenture Redemption Reserve</i>	5

The company has already given loans to the following companies:

- | | |
|-----------------------|---------------|
| (i) Peters Ltd. | Rs. 5 crores |
| (ii) Steel India Ltd. | Rs. 10 crores |

The Company has also given a corporate guarantee of Rs. 10 crores to NR & Co. Ltd.

Advise whether the Board can go ahead with the above proposal. (8 Marks)

- (b) The subscribed share capital of AJR Company Ltd. at the end of the financial year ending 31st March, 2005 was Rs. 20 crores, out of which two public Financial Institutions were holding share capital amounting to Rs. 3 crores. During the financial year 2005-2006 the company through public issue of shares raised its subscribed capital by additional Rs. 60 crores. Out of Rs. 60 crores, the two public financial institutions were further allotted shares amounting to Rs. 20 crores, raising the total contribution of these two institutions to Rs. 23 crores before the date of the company's closure of books for annual general meeting scheduled for 15th September, 2005, where auditors were to be appointed. The company as usual, by getting an ordinary resolution passed appointed the auditors. A group of shareholders of the company allege that the appointment of auditors is violative of certain provisions of the Companies Act, 1956. They however, did not raise any objection to the appointment of auditors at the previous annual general meeting held on 10th September, 2004. Examining the provisions of the Companies Act, 1956 decide:

- Whether contention of the shareholders shall be tenable?
- Should the contention of shareholders be tenable, what action is the company required to take for the appointment of auditors in the above situation at the annual general meeting scheduled for 15th September, 2005 ?
- Would your answer be still the same in case the total subscribed capital contributed by the two public financial institutions in only Rs. 10 crores, including the previous contribution of Rs. 3 crores ? (7 Marks)

Answer

- (a) Problem on Inter-Corporate Investment

In accordance with the provisions of the Companies Act, 1956, as contained in Section 372A, Companies Act, 1956 a company cannot grant any loans or inter corporate investment exceeding 60% of its paid up capital and free reserves or 100% of its free reserves, whichever is more.

In case of VCD Ltd. the position as at 31st March, 2006 is as under:

Paid-up share Capital:	Equity Share Capital :	Rs. 50 crores
	Preference Share Capital:	Rs. 10 crores
General Reserves		Rs. 100 crores

Total Rs. 160 crores. (60% of Rs. 160 crores = Rs. 96 crores)

100% of Reserves & Surplus (i.e. General Reserve) Rs. 100 crores.

As 100% of free reserves, i.e. Rs. 100 crores is more than 60% of paid up share capital (both Equity and Preference share Capital) and free reserves, i.e. Rs. 96 crores, therefore, the overall limit for release of loan is Rs. 100 crores.

The company has already granted loan / given guarantee as under:

(i)	Peters Ltd.	Rs. 5 crores
(ii)	Steel India Ltd.	Rs. 10 crores
(iii)	Corporate Guarantee	Rs. 10 crores
	Total	Rs. 25 crores

Balance of limit upto which further loans/guarantee can be given = Rs. 100 crores – 25 crores = Rs. 75 crores

Therefore, the company can grant loan upto Rs. 75 crores to JN Ltd. Loan upto Rs. 80 crores as proposed can be given provided a special resolution in company's general meeting has been passed as required under Section 372A of the Companies Act, 1956. It may however, be noted that the special resolution as required must be passed through postal ballot in accordance with the rule 4 of the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001.

(b) Appointment of Auditors by Special Resolution (Section 224 A, Companies Act, 1956)

The problem as asked in the question is based on the provisions of Section 224A of the Companies Act, 1956. The section provides for the appointment of auditors in certain cases only by a special resolution. Normally the auditors are appointed by passing ordinary resolution. In terms of Section 224A, a company in which not less than 25% of the subscribed capital is held by:

- (i) a Public Financial Institution or a Government company or the Central Government or any State government, or
- (ii) any financial or other institution established by any Provincial or State Act in which a State Govt. holds not less than 51% of the subscribed share capital, or
- (iii) a nationalized bank or an insurance company carrying on general insurance business, or
- (iv) any combination of the above categories shall appoint or re-appoint an auditor in the annual general meeting only by passing a special resolution.

In case the aforesaid company omits or fails to pass a special resolution in the annual general meeting to appoint an auditor or auditors it shall be deemed that no auditor or auditors have been appointed, and thereupon the Central Government's power to appoint the auditors pursuant to Section 224(3) will become exercisable. In determining whether the appointment calls for a special resolution or not the measuring yardstick is the proportion of the subscribed capital held by the various

categories mentioned above. If any of them singly or several of them jointly held 25% of the subscribed capital of the company as on the day of the closing of the register of members before the AGM of the company, it will be covered by the provisions of Section 224A. and consequently, the appointment of the auditor can only be made by passing a special resolution.

The Department of Company Affairs has clarified that the material date is the date for considering the 25% holding is the date of the AGM at which the resolution is required to be passed. Moreover, since generally articles of association of the companies provide for closure of the register of members before the general meeting during a period not exceeding in 30 days at any one time, it is unlikely that the position regarding shareholding in the company will be different between the date of issue of notice and date of the general meeting.

Therefore, applying the above provisions in the given case answers to the question shall be as under:

1. Since in the first case the public financial institutions holds the total subscribed share capital to an extent of Rs. 23 crores (i.e. in excess of 25% of the subscribed share capital on the date of AGM i.e. 15 September, 2005) the appointment of auditor shall be made by special resolution as required under Section 224A. The company, therefore, has violated the provisions of Section 224A, since the company has passed only ordinary resolution instead of passing special resolution. Therefore, it shall be presumed as if no auditors have been appointed and the Central Government shall exercise its power for appointing the auditors. The contention of the shareholders is tenable.
2. Since the contention of the shareholders in the first case is tenable, in the second case the company shall, within 7 days of the Central Govt.'s power under sub-section (3), becoming exercisable, gave notice of that fact to that Govt. and if a company fails to give such notice, the company and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5,000 (Section 224(3))
3. Answer in the third part will differ, i.e. the shareholders contention shall not be tenable as the subscribed capital of the financial institution is less than 25% of the total subscribed capital of the company.

Question 6

- (a) *The Executive Committee of an Inter-state Co-operative society decides to convert the society into a 'Producer Company' under the provisions of the Companies Act, 1956. You being a practicing Chartered Accountant are approached by the society for advice. Advise the society on the following matters:*
- (i) *The steps to be taken for conversion of the society into a 'Producer Company'.*
 - (ii) *Manner in which voting rights of members of Producer company after conversion may be exercised.*
- (8 Marks)

- (b) Referring to the provisions of the Companies Act, 1956, as contained in Section 397 of the Act, Examine whether the following Acts of the company amount to oppression:
- (i) Allotment of shares by the Directors of the Company by which the existing majority is reduced to minority.
 - (ii) Allotment of shares by the Directors by which the existing minority shareholders are made to majority.
 - (iii) A share sale agreement was executed by VC, an NRI. The shares and transfer deed were handed over to an escrow agent. The sale was subject to RBI permission. The shares were not transferred for 6 years since RBI permission was not received. VC, after waiting for a long period of time raises the issue and complains of oppression in the capacity of a member. As per the agreement the sale was unconditional. During the above period VC did not exercise any right as shareholder nor the company treated him as a member. (7 Marks)

Answer

- (a) Conversion of inter state cooperative society into producer company steps to be taken and manner in which voting rights of members after conversion to be exercised. [Section 581J and 581D The Companies (Amendment) Act, 2002.]

As a practicing Chartered Accountant the following advise can be given to the inter-state society which wants to get converted into a 'Producer company' under the provisions of Companies (Amendment) Act, 2002.

1. Steps to be taken for conversion (Section 581J):

Any inter-state cooperative society having objects for multiplicity for states may make an application to the Registrar for registration as producer company. Such application should be accompanied by –

- (a) A copy of the special resolution, of not less than 2/3rd of total member of Inter-State Cooperative Society, for its incorporation as a producer company.
- (b) A Statement showing : (i) names and address or the occupation of the directors and Chief Executive, if any, by whatever name called, of such inter-state cooperative society; and (ii) list of members of such inter-state cooperative society.
- (c) A statement indicating that the inter-state cooperative society is engaged in any one or more of the objects specified in Section 581B.
- (d) A declaration by two or more directors of the inter-state cooperative society certifying that particulars given in clauses (a) to (c) given above are correct.

The word "Producer Company Ltd." should form part of its name to show its identity. On compliance with the requirements of the Act, the Registrar shall, within a period of 30 days of the receipt of application, certify under his hand that the society applying for registration is registered and thereby incorporated as a producer company.

Upon registration as a producer company, the Registrar of Companies who registers the company is required to intimate the Registrar with whom the erstwhile inter-State cooperative society was earlier registered for appropriate deletion of the society from its register.

2. Manner in which voting rights of members can be exercised (Section 581Z):

Section 581Z of the Companies Act, 1956 states that subject to the provisions of sub-sections (1) and (3) of Section 581D, every member shall have one vote and in the case of equality of votes, the chairman or the person presiding shall have a casting vote except in the case of election of the chairman. As regards the voting rights it may be noted that:

1. Where individual is a member of the producer company, he has one vote irrespective of the size of his holding.
2. Where both individuals and producer institutions are members – single vote for every member.
3. Where membership is confined to producer institutions only, in the first year of registration of the company, the voting rights shall be based on the size of the shareholding of the member institution and in the following years it will be based on participation by the respective institutions in the business of the producer company in the previous year (as may be specified in the Articles),
4. A producer company, may, if authorized by the Articles, restrict the voting rights to active members of the producer company, and
5. Casting vote can be cast by the presiding member (Chairman) in case of equality of votes on any resolution (except for election of the Chairman).

(b) Acts of oppression (and the action to be taken against the company): Section 397 of the Companies Act, 1956 provides that any members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members (including any one or more of themselves) may apply to the National Company Law Tribunal (NCLT) for an order under this section, provided such members have a right so to apply by virtue of Section 399 [Sub section (1)]. Further, if on any application as stated, the NCLT is of opinion -

- (a) that the company's affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members;
- (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up;

the NCLT may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

Applying the above provisions answers to the given questions are:

1. In the first question allotment of shares by the directors of a company by which

the existing majority is reduced to minority amounts to oppression and appropriate action can be taken against the company. (*Gluko Series (P) Ltd., in Re. (1987) 61 Comp. Cas. 227 (Cal.)*). *Anand Kumar Saigal v. Manu Properties (P) Ltd. (2001) 32SCL 367 (CLB)*.

2. In the second case also allotment of shares to turn minority to majority amounts to an act of oppression. And appropriate action as stated above can be taken against the company.
3. The act as given in the question does not amount to oppression and no action can be taken against the company under section 397. (*Mrs. Jameela Beevi v. Narmada Bldg. Enterprises (P) Ltd. (2004) a50 SCL 610 (CLB)*). *Rajiv Mehta v. Group 4 Securities Hindustan (P) Ltd., CLB. Principal Bench, New Delhi (1998) 18 SCL89*)

Question 7

- (a) (i) *Mr. John has been appointed as Additional Director on the Board of MCX Ltd. on 12th January, 2006. Mr. John has filed his consent to Act as a Director, if appointed, only with the company. Examine with reference to the provisions of the Companies Act, 1956 whether he is also required to file his consent with the Registrar of Companies.*
- (ii) *One of the members of ADB Ltd. has proposed the name of Mr. Fame for appointment as a Director of the Company in the Annual General Meeting and given a notice under Section 257 of the Companies Act, 1956. Mr. Fame is one of the partners of the Fame & Fame, Chartered Accountants, who are the retiring auditors of the company. But the audit of the company is being looked after by another partner of the firm. Examine whether Fame & Fame can be reappointed as auditors, if Mr. Fame is appointed as Director. (8 Marks)*
- (b) *Examine the validity of the following:*
 - (i) *The Board of Directors of a company decides to revise the accounts which have been submitted to the Auditors, but the auditors have not yet given their report.*
 - (ii) *The Board of Directors of a company decides to revise the Audited accounts before adoption by the shareholders in the Annual General Meeting.*
 - (iii) *The Board of Directors of a company decides to revise the accounts which have already been adopted by the shareholder in the Annual General Meeting. (7 Marks)*

Answer

- (a) (i) **Filing of consent under section 264:** Problem as asked in the question is based on the provisions of Section 264(1) and (2) of The Companies Act, 1956 and also the case ruling in *Lalitbhai C. Kapadia Vs. Laljibhai B. Desai*. Section 264(1) of the Companies Act, 1956 requires that a person proposed as a candidate for the office of director should file with the company his consent to act as a director, if appointed. Section 264(2) stipulates that a person shall not act as a director unless he has filed

with the Registrar of Companies his consent in writing (Form No. 29) to act as such. Additional and alternate directors are not required to file consent under section 264(2) (*Lalitbhai C. Kapadia v. Laljibhai B. Desai* (1973) 43 Comp. Cases 17). Accordingly, applying the above provisions and the ruling of the case, John is not required to file his consent for accepting Additional Directorship.

- (ii) Appointment of a partner of the company's auditors as a director: Problem as asked in the question is based on the provisions of Companies Act, 1956 as contained in Section 2(30) read with Section 226(3)(b) and (c). Accordingly, Mr. Fame is appointed as a director of the company 'Fame and Fame' cannot be reappointed as company's auditors. It is so because a director is an officer of the company within the meaning of section 2(30) of the Companies Act, 1956 and the audit firm becomes disqualified under section 226(3) (b) and (c) even if any of its partner is also an officer of the company. It is immaterial that the audit of the company is being looked after by another partner of the firm and not by Mr. Fame. Therefore, if Mr. Fame is appointed as a director of the company, 'Fame and Fame' cannot be reappointed as company's auditors.
- (b) Revision / rectification of accounts
- (i) Revision of Accounts Before the auditors have given their report: The Board of directors of the company is competent to revise the accounts. The revised accounts are required to be approved at a Board meeting and properly authenticated as required under Section 215 of the Companies Act, 1956 before they are sent to the auditors for their report thereon.
 - (ii) Board of Directors of a company decides to revise the audited accounts before adoption by the shareholders in AGM: The Board of Directors of the company can revise the accounts and re-submit the same to the auditors for their report thereon provided the original accounts have not been placed before the shareholders at the AGM. The Auditor's Report on the revised accounts will be in substitution of their earlier report on the original accounts. However, adequate disclosure as regards revision of accounts and auditor's report should be made in the revised accounts and auditor's report respectively. (Guidance Notes on Auditor's Report on Revised Accounts of Companies before circulation to shareholders).
 - (iii) Board of directors decide to revise the accounts which have already been adopted by the shareholders in the AGM: The Institute of Chartered Accountants of India have opined that the accounts once adopted by the members of a company cannot be reopened under any circumstances.

However, Department of Company Affairs clarified in 1987 that a company could reopen and revise its accounts even after their adoption in the Annual General Meeting in order to comply with technical requirements of taxation laws.

In the absence of any provision in the Companies Act, 1956 in this regard, reopening/revision of accounts in appropriate cases is not completely prohibited. In such event, the revised annual accounts would be required to be adopted in the

subsequent Annual General Meeting / Extraordinary General Meeting and filed with the Registrar of Companies after such adoption.

Question 8

- (a) *PQR Machines Ltd. Entered into a contract with MN forgings, in which wife of P, a director of the company is a partner. The contract is for supply of certain components by the firm for a period of three years with effect from 1st September, 2005 on credit basis. The paid-up Share Capital was increased from Rs. 70 lakhs to Rs. 140 lakhs on 1st March, 2006. Explain the requirements under the Companies Act, 1956, which should have been complied with by PQR Machines Ltd. before entering into contract with MN Forgings. Whether there is any additional requirement which is required to be complied with by PQR Machines Ltd. in view of the increased paid-up Share Capital on 1st March, 2006.*

What would be your answer in case MN forgings is a Private Company in which P's wife is holding substantial shares ? (8 Marks)

- (b) *Imprudent Company Ltd. approached Safe Finance Company Ltd. for a loan of Rs. 20 lakhs to finance purchase of some essential machinery. The company created a floating charge on some of its assets on 1st December, 2004 for Rs. 25 lakhs to secure Rs. 5 lakhs already due to Safe Finance Company Ltd. and additional amount to be advanced by the said Finance Company. Safe Finance Company Ltd. advanced Rs. 15 lakhs on 15th December, 2004 towards purchase of certain machinery. Some of the creditors filed winding up petition in the court on 1st January, 2005 on the ground that the company was unable to pay its debts and the company was ordered to be wound up on 15th December, 2005. Examine with reference to the provisions of the Companies Act, 1956 whether the floating charge is valid.* (7 Marks)

Answer

- (a) Contracts in which directors are interested: The contract for supply of components entered into between PQR Ltd. and MN Forgings, a partnership firm (on which wife of P, a director of the company is a partner) attracts Sections 297, 299, 300 and 301 of the Companies Act, 1956.

The contract cannot be entered into unless it is approved in the meeting of the Board of Directors of PQR Ltd. Specific Board resolution is required (Section 297). However, in case of urgent necessity such consent of the Board may be obtained within 3 months of the date on which the contract was entered into (Section 297(3))

P, the interested director must disclose his interest at the Board meeting at which the question of entering into the contract has been taken up for consideration (Section 299(1) & (2)). P, the interested director should not have taken part in the discussion at the said board meeting and he should not have voted on the resolution in respect of that contract (Section 300)

Prescribed particulars of the contract must be entered into the Registrar of Contract maintained under Section 301 within 7 working days of the Board meeting (Section 301).

In the given case the contract was entered into on 1.9.2005 for supply of components for a period of 3 years. As the paid-up share capital was only Rs. 70 lakhs (i.e. less than Rs. 1 crore) on 1.9.2005 proviso to Section 297(1) requiring prior approval of the Central Government is not attracted. Subsequent increase in the paid up share capital beyond Rs. 1 crore will not make it necessary to get the approval of the Central Government for continuation of the contract for the remaining period. Hence, there is no additional requirement.

If MN Forgings is a private company the provisions of Section 297 are not attracted as the director of PQR Ltd. is a director or member of MN Forgings Private Ltd.

Section 299 is also not attracted for the reasons given below:

If the contract or arrangement is between companies, a director is deemed to be interested only if he singly or along with other directors hold 2% or more shares in other company (Section 299(6)). While calculating the 2% shares in other company, only investment of directors is considered. Here P, a director of PQR Ltd. is not holding any shares in MN forgings Pvt. Ltd. Shares held by P's wife are not to be considered. Hence the provisions of Section 299 are not attracted. Sections 300 and 301 are also not applicable.

- (b) **Effect of floating charge:** The effect of floating charge in case of winding up of the company is dealt with in section 534 of the Companies Act, 1956. Accordingly, any floating charge made within 12 months preceding the commencement of winding up is void, unless it is proved that the company was solvent immediately after the creation of the charge. However, charge is valid in respect of any sum advanced at the time of creation of charge or subsequent to the charge together with interest at 5% or such other rate as may be notified by the Central Government.

In the given case though the winding up order was passed by the court on 15.12.05. The winding up shall be deemed to have commenced at the time of presentation of the petition for winding up i.e. 01.01.2005 (Section 441(2)). As regards floating charge was created on 1.12.04, it was within 12 months preceding the commencement of winding up. The company also could not be considered as solvent, as it was ordered to be wound up on the ground that it was unable to pay its debt.

The finance company advanced a total sum of Rs. 20 lakhs, out of which Rs. 15 lakhs was advanced after the creation of floating charge. Hence, the floating charge is valid only for Rs. 15 lakhs together with interest at 5% p.a. (and not 12%).

Question 9

- (a) *EF Chemicals Ltd. proposes to appoint one whole-time technical Director on a consolidated monthly remuneration of Rs. 30,000 and one whole-time Marketing Director on a consolidated salary of Rs. 25,000 per month for a period for three years with effect from 1st September, 2005. The company has got a Managing Director and he is getting Rs. 40,000 per month. Explain the requirements under the companies Act to be complied with by the company in connection with the proposed appointment of whole-time Directors taking into account the following data collected from the Balance Sheet of*

the company as on 31st March, 2005:

	Rs.
1. Paid-up Share Capital	80,00,000
2. Debentures redeemable after three years	90,00,000
3. Investments	20,00,000
4. Accumulated Loss	70,00,000
5. Preliminary Expenses not written off	15,00,000
	(8 Marks)

- (b) A Public Company proposes to appoint an alternate Director for one of its Directors, who is likely to be outside India for most of the year. There is no specific provision in the Articles of Association in this regard. State the steps to be taken by the Company to give effect to the proposal.

Draft a specimen resolution for appointment of alternate Director and also state the kind of meeting at which such resolution is to be passed. (7 Marks)

Answer

- (a) Appointment of whole time directors: In the given case two whole time directors are proposed to be appointed with effect from 1st September, 2005. The remuneration payable to these directors depends on the effective capital of the company on the last day of the preceding financial year i.e. 31.3.2005. The effective capital is Rs. 65 lakhs (Rs. 80 lakhs + 90 lakhs – Rs. 20 lakhs – Rs. 70 lakhs – Rs. 15 lakhs) on 31.3.2005.

The ceiling on minimum remuneration has been prescribed in Part II of Schedule XIII of the Companies Act, 1956. Here the Managing Director is already getting a minimum monthly remuneration of Rs. 40,000. The proposed minimum remuneration to the whole-time technical director is Rs. 30,000 p.m. and to the whole time marketing director is Rs. 25,000 p.m. If a company has more than one managing director and / or whole-time director, the company may pay to each of them minimum remuneration within the prescribed ceiling. As the effective capital is less than Rs.1crore, the company may pay to each of the Managing Director/whole time director minimum remuneration upto Rs. 75,000 p.m. Hence the proposed minimum remuneration is within the prescribed limits.

The remuneration payable to the whole-time directors must be approved by Remuneration Committee of the Board of Directors, and thereafter the appointments of the Technical Director and Marketing Director shall be approved at a Board meeting.

Abstract of terms of appointment of whole-time directors must be sent to every member within 21 days as required under section 302(2). Nature of concern or interest of each director must be disclosed.

Copy of Board resolution, Form No. 32, Directors consent in Form No. 29 must be filed with the Registrar of Companies.

Return in Form No. 25C must also be filed within 90 days from appointment as required

under section 269(2). The return must contain a certificate from the auditor or the Secretary of the company or a Secretary in Whole-Time Practice that the requirements under Schedule XIII have been complied with Part III of Schedule XIII – Para 2)

The appointment and remuneration of the whole-time marketing and technical directors must be approved in next annual general meeting by ordinary resolution (Section 305(1) and part III of Schedule XIII).

The company has to comply with the above requirements under the Companies Act, 1956 with regard to the proposed appointment of two whole-time directors.

- (b) Alternate Director: In accordance with the provisions of the Companies Act, 1956 as contained in Section 313 Board of Directors of any company (public or private) may appoint an alternate director, if so authorized by its Articles. In the absence of an enabling provisions in the Articles, the Board may be empowered with this power by an ordinary resolution passed in a general meeting. The company in general meeting cannot itself exercise such power of appointment. It can only empower the Board to make the appointment at the Board's discretion. The company must convene an extra - ordinary general meeting and pass an ordinary resolution as stated above (it is not necessary to alter the Articles of Association) and thereafter pass a Board Resolution for appointment of alternate director.

Specimen Board Resolution: Resolved that pursuant to Section 313 of the Companies Act, 1956 and the ordinary resolution passed at the EGM held onMr.be and is hereby appointed as an alternate director for Mr., Director to hold office during his absence for a period of not less than three months from the State of in which meetings of the Board are ordinarily held [alternatively to hold office of the alternate director for a period of Provided, however, that he shall, during the stated period, vacate the office as and when the original director returns to the state and shall assume the signature on behalf of Board of Directors office as and when the original director goes out of the State.

Signature on behalf of Board of Directors